CROSS-MODAL OWNERSHIP IN PASSENGER TRANSPORT – THE BRITISH EXPERIENCE SINCE 1985

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ABSTRACT

The 1998 UK Government White Paper set out to "produce better public transport, with easier, more reliable connections" through "a modern integrated transport system" whilst addressing the issue of "inadequate regulation of monopoly supply". The predominantly public sector structure of ownership in Great Britain had been dismantled through the privatisation of the bus industry and the franchising of rail passenger services in the period since 1985. However, an initially fragmented private sector structure developed into a highly concentrated one, through merger and takeover activity within each sector and the creation of a significant level of cross-ownership between the two sectors.

This paper sets out to address the dual issues of how and why this level of cross-modal ownership had developed. Additionally, the question of whether cross-ownership has any discernible impact on the effectiveness of integrated transport is pursued. Specifically examined is the corporate motivation for such diversification, through which the degree of natural synergy and overlap between the sectors is identified.

The paper draws on recent original discourse by a selection of key managers and officials involved in the privatisation, consolidation and diversification processes. Supplemented by reference to other published work on the subject, this is used to provide a number of contrasting perspectives on the issues raised.

The conclusion is that generally, although not exclusively, cross-modal ownership has been driven by Stock Market pressure for business growth more than any other factor. There is some evidence of transferability of management expertise between sectors. However, it seems that any integrated transport or managerial/economy of scale benefits that have arisen specifically through cross-modal ownership have been marginal and peripheral to the main driving force.

1 INTRODUCTION

The 1993 Railways Act set out the framework for the privatisation of British Rail. In the passenger sector, this was to be achieved by splitting operations into 25 individual franchises which were to be let on a fixed term basis. This process attracted significant level of interest from transport groups which had grown from the former state owned bus operations, which themselves had been created as a result of the 1985 Transport Act. The resulting cross-modal ownership restarted a process which had begun nearly 100 years previously, namely that of cross-ownership between the two sectors.

This paper aims to examine the development of this ownership pattern, principally concentrating on its motivation and effects in the period since the privatisation of the road passenger and rail industries in the 1980s and 1990s. It begins by placing in historical context the cross-modal links which began to develop about 100 years ago and also makes brief reference to the effects of the 1947 and 1968 Transport Acts which placed much of the transport operations in state hands. The paper provides overviews of the privatisation of the bus and rail industries in Britain in the 1980s and 1990s and then looks in some detail at the way in which strong cross-modal ownership links have developed. The paper also considers the effects of these ownership links, particularly in the context of a contradictory regulatory regime – one which wants attractive, integrated transport through its transport policy, but appears to discourage integration through its competition policy.

The information is derived from published sources, supported by discourse data obtained from a number of key individuals who have been actively involved in the privatisation, consolidation and diversification processes. The

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wider work, of which this paper forms a part, is being undertaken by the author at the Institute for Transport Studies, University of Leeds, UK and is being funded in part by the Rees Jeffreys Road Fund. A key element of the discourse strategy is one of anonymity and there is hence no reference by name to the individuals within this paper, other than where the discourse has been obtained from sources in the public domain.

2 HISTORICAL CONTEXT

Hibbs (1989) traces cross-modal ownership between the road passenger and rail sectors tracing back to the very early years of the 20th century. The Great Western Railway (GWR) acquired a fleet of motor buses in 1903, having seen their success elsewhere in the country, and used then as an alternative to extending the railway line to places of low population density. The North Eastern Railway also began services in 1903 and, within a few years, railway buses were running in many other parts of Great Britain (Hibbs 1989: 47/48).

The 'big four' railway companies were created in 1923 (Hibbs 1989: 98). Hibbs postulates that the ensuing reorganisation preoccupied railway management at a time when the potential threat of the motorbus was at its greatest. In order to counter much of this threat, and because of concern that the powers they had to run their own bus services were of doubtful legality, the four main line railway companies, and the Metropolitan Railway, promoted Bills in Parliament to permit them to operate road passenger (and goods) vehicles. The Railway (Road Transport) Acts of the main line companies became law on 3 August 1928 (Hibbs 1989: 99)

Rather than expand their own bus networks, the four companies undertook to invest in the contemporary bus industry. In 1928, the railways and the Tilling and British Automobile Traction Company agreed that the railways take a 50% ownership of T&BAT. The story of partial ownership by the railways is told in some detail by Hibbs (1989: 100-104 et seq) and how it specifically affected one company by Crosland-Taylor (1948: 40-44 et seq)

The election of a Labour government in 1945, with a mandate to take many utilities into state ownership, further consolidated the various modes of public passenger transport under the ownership of a single organisation. Under the 1947 Transport Act, a structure was created such that a series of Executives reported to the British Transport Commission (BTC) which, in turn, was answerable to the Minister of Transport (see diagram in Aldcroft 1975: 76). This also brought London Transport into the same fold, the London Transport Executive having been created in 1933, also as described by Aldcroft (p55-56 et seq). Operation of the nationalised transport industry is described in some detail by Thompson and Hunter (1973). The final consolidation under government ownership, other some minor 'tidying up' in the 1970s, was the purchase of the shares in bus companies which had been retained by BET in the aftermath of the 1947 Act. These were bought by the government in 1969 and, with the pre-existing state owned bus companies in England and Wales, formed the basis of the National Bus Company. The path of BET into state ownership is told by Booth (1999: 22-27 and 90/91).

The 1968 Transport Act, as well as paving the way for the purchase of BET shares described above, also put the control (although not all of the operation) of passenger transport systems in seven metropolitan areas under the control of Passenger Transport Executives, with a mandate to develop an integrated transport system. In the remainder of the country, the bus licensing system had the aim of ensuring that much the same happened.

Both the 1947 and 1968 Acts went further than ownership by envisaging integration between the modes. The 1947 Act, empowered the British Transport Commission to provide "… an efficient, adequate, economical and properly integrated system of public inland transport" which in the view of Aldcroft (1974: 72) would enable it to provide a more rational allocation of the use of resources. Similarly, the 1968 Act had, as its principal objective, the promotion of the integration of inland passenger transport (ibid: 97), most specifically in major urban areas. The last vestiges of these Acts, insofar as integration is concerned, were dismantled during the 1980s and 1990s, as described in sections 3 to 5.

3 BUS PRIVATISATION

The ownership regime of the bus industry was restructured by the Transport Act 1985. Prior to this, and during a period of reasonable stability prior to the 1985 Act, the ownership structure can be summarised under six generic headings (Ian Allan 1980); brief descriptions of these, and their post 1985 development, are given in an appendix to this paper.

In July 1984, the Government issued the White Paper *Buses* (Cmnd 9300). As described by Pickup et al (1991) and others, the ensuing 1985 Transport Act made five specific changes to the structure and operation of the bus industry, two concerned with regulation, three concerned with ownership. ‘Deregulation’ allowed any licensed operator to provide a service on any route of their choosing (outside London) with a minimum of formality. With regard to ownership, the changes were:

1. The privatisation of the National Bus Company, through the individual selling off of its operating subsidiaries or, in some cases, subdivisions of them.
2. The operation of the Scottish Bus Group as separate subsidiaries within the competitive framework created by the Act. The 1985 Act did not specifically provide for privatisation of the SBG; this was subsequently catered for by the 1989 Transport (Scotland) Act.
3. Changes in ownership of municipal and PTE operations, whereby ‘arms length’ subsidiary limited companies were to be created. These were to take over bus operation from the local authority bodies with effect from 26 October 1986 and, although there were no specific provisions in the Act for enforced privatisation of these companies, the Secretary of State for Transport could give permission for this to take place if approached.

The effect of this legislation has been that the vast majority of companies which were in the public sector in 1985 have been transferred to the private sector. A total of 116 state owned bus and coach companies have been sold since 1986. An analysis of their sale by purchaser type appears in table 1. These are categorised as trade sales, where the purchaser is wholly external to the pre-existing business, or as management or employee buyouts. In reality, there is often significant overlap between the latter two categories. For the purposes of this research, an employee buyout is defined as one where at least 25% of the equity was acquired by a significant part of the whole workforce on a reasonably equitable basis; a management buyout is one in which the majority of the shares were acquired by a few senior managers.

Table 1: Bus company privatisations by vendor and purchaser (1986 to date)

Vendor	Management buyouts	Employee buyouts	Trade sales	Total
National Bus Company	36	2	20	58
Scottish Bus Group	0	5	5	10
Local authorities	1	12	15[2]	28[1]
Passenger Transport Authorities	0	8	0	8
London Buses Limited	3	3	6	12
Total	**40**	**30**	**46**	**116**

Notes:

[1] In addition, 17 companies remain substantially in local authority ownership as at June 2001 and one (Darlington) ceased to trade before a sale could be completed. Minority private sector interests exist at Nottingham and Eastbourne.

[2] Includes the ‘distress sales’ at Barrow, Cynon Valley, Inter Valley Link, Lancaster, Maidstone, Merthyr Tydfil and Taff-Ely.

Updated from: Roberts (2000)

The disposal process was still in its early stages when privatised companies, as complete entities or in parts, began to change hands. The onward sales have continued ever since, to the extent that, other than companies which were sold directly by NBC to emerging groups, only seven have remained largely with the original purchasers. The same process has been repeated with the companies sold from other sources. Only one of the ex Scottish Bus Group companies remains outside the control of a major group; none of the ex PTA companies and only one of the ex municipal businesses remain independent. Of the ex London Buses subsidiaries, Metroline began to develop into a group in its own right following flotation but was subsequently purchased by Singaporean based DelGro, whilst London United is the major UK transport interest of the French company Transdev SA, the others all being owned by the major British groups.

The time between initial purchase and onward sale has varied between 12 weeks and 10 years. The mean time between buyout and resale is fractionally over four years, although this excludes those which remain in substantially the same ownership as at privatisation, have achieved a Stock Market listing or (in one case) gone into receivership.

A key motivator for management and/or employee owned companies is the ability for the owners to be able to realise their purchase, ie increase the value of the company by improved performance and then, either in cash or ‘on paper’ terms, accrue a windfall return. Chiplin, Wright and Robbie (1988) identify a number of ways of this occurring:

1. Flotation, on the fully quoted Stock Market or one of the junior unlisted markets

2 Acquisitions by other companies
3 Other forms, such as recapitalisation or restructuring, a management buy-in (increasingly likely with the number of cash rich former management buyout teams who had realised their investment by resale) or, in extreme cases, the appointment of a receiver or administrator

To date, all but one of the management and/or employee owned companies have exited from their buyout phase. A summary of their type of exit appears in table 2.

Table 2: Realisations of bus company management and/or employee buyouts (as at June 2001)

	Management buyout				Employee buyout			
Vendor	**Total**	**Trade sale**	**Flotation**	**No realisation**	**Total**	**Trade sale**	**Flotation**	**No realisation**
National Bus Company	36	27[1]	4[2]	5[3]	2	2	0	0
Scottish Bus Group	0				5	5	0	0
Local authorities	1	1	0	0	11	9	1[2]	1[3]
Passenger Transport Authorities	0				8	8[4]	0	0
London Buses Limited	3	3	0	0	4	3	1[2, 5]	0
Total	**40**	**31**	**4**	**5**	**30**	**27**	**2**	**1**

Notes:
1 Includes the distress sale by the management buyout team at National Welsh.
2 Flotations: ex NBC: Badgerline, National Express, Northern General (Go-Ahead), Southern Vectis; ex local authority: Grampian Regional Transport; ex London Buses: Metroline
3 No realisation: ex NBC: Ambassador Travel, East Yorkshire, Trent, Wilts and Dorset, Yorkshire Traction; ex local authority: Preston.
4 Merseyside Transport initially realised through financial restructuring but ultimately through a trade sale.
5 Metroline initially realised through flotation but ultimately through a trade sale.

Source: Author, based on *Buses* (1996) and updated

The overall effect of this process has been to consolidate bus company ownership in the hands of a small number of dominant, private sector groups. The market shares of these groups by turnover as at September 1999 is as given in table 3, adjusted to take account of the Arriva takeover of MTL in February 2000.

Table 3: Bus industry market share by turnover (September 1999)

Rank	**Group**	**% market share**
1	FirstGroup	22.95
2	Stagecoach	16.39
3	Arriva (including MTL)	15.70
4	Go-Ahead	6.52
5	National Express	6.26

Source: TAS (1999)

4 RAIL INDUSTRY PRIVATISATION

The 1993 Railways Act paved the way for privatisation of the railways. Infrastructure, rolling stock and support services were sold off separately but the pattern of operation of passenger services was protected by a governmental body (the Office of Passenger Rail Franchising (OPRAF)). The operation of passenger services was to be via 25 franchises and the bidding for these began in May 1995. [For an outline of the structure as originally created, refer to Charlton (2000), particularly the diagram on page 34.]

The process of selling the franchises is described by Wolmar and Ford (2000: 147-177). The Department of Transport initially claimed to have received interest from 150 parties. Many of these did not, or were not able to, pursue their interest and it is estimated that a more realistic number of genuine bidders was between 25-30 from outside the industry, plus management/employee bids from the incumbents at the vast majority of franchises. By the shortlisting stage, the number of bidders had been whittled down to 15, plus the various MEBO interests. Table 7.1 in Wolmar and Ford (2000: 151) gives full details of these; the information is summarised here in table 4.

Table 4: Summary of British rail franchise shortlisting 1995-97

Company type	Company	Shortlisted bids		Successful bids	
		Solo	Joint	Solo	Joint
Transport operator (with bus interests)	National Express	10	0	5	0
	Stagecoach	14	1	2	0
	FirstGroup	2	4	1	1
	MTL	4	0	2	0
	Go-Ahead	1	1	0	1
Transport operator (without bus interests)	Sea Containers	4	0	1	0
	Virgin	6	0	2	0
Rail operator	Prism	12	0	4	0
	GB Rail	6	0	1	0
	Resurgence	2	0	0	0
Utility conglomerate	CGEA	6	3	2	0
Joint venture: transport operator (with bus interests) and conglomerate	Go-VIA	2	1	1	0
	Halcrow Cowie	1	1	0	0
Joint venture: transport operator (with bus interest), MBO and venture capitalist	GW Holdings	3	1	1	1
Management buyout	M(E)BOs (various)	5	12	0	3

Adapted from: Wolmar and Ford (2000: 151)

As can be seen from table 4, transport groups with some kind of bus industry ownership link were amongst the most successful of the bidders. The actual allocation of franchises was as summarised in table 5, using the generic company ownership types used by Harris and Godward (1997: 100).

Table 5: British railway franchises as originally let (1996/97)

Ownership type	Number	Franchisee	Number
Rail operator	2	Prism Rail	4
		GB Railways	1
Transport operator	2	Sea Containers	1
		National Express	5
Bus operator	3	Stagecoach	2
		FirstBus	1
		MTL Trust Holdings	2
Bus operator/utility	1	Go-Ahead/Via-GTI	1
Utility conglomerate	1	CGEA (Connex)	2
Mini conglomerate	1	Virgin	2
Management buyout	3	M40 Trains	1
		GW Holdings	2
		Victory Railways	1

Note:
Management buyouts supported as follows: M40 Trains (John Laing and 3i), GW Holdings (FirstBus and 3i), Victory Railways (Go-Ahead)

Source: Harris and Godward (1997: 100)

Table 5 clearly shows the interrelationship of ownership between the bus and rail industries. As well as the companies which had their origins in the post privatisation bus industry in the UK (Stagecoach, FirstGroup, National Express, Go-Ahead and MTL), French based Connex have major urban transport interests in continental Europe and Prism Rail's founders all had experience in the bus industry. Thus, with the exception of Anglia Railways (owned by GB Rail), InterCity East Coast (Sea Containers), Cross Country Trains and InterCity West Coast (Virgin) and Chiltern Railways (MBO), all the other franchise awards had some form of direct link to the bus industry.

As had already happened in the bus industry, consolidation began to happen between the owners of rail franchises. The principal events were as listed in table 6.

Table 6: Principal events affecting ownership of rail franchises

Date	Franchisee	Notes
March 1998	GW Holdings	Acquired by FirstGroup (itself renamed from FirstBus)
April 1998	Victory Railways	35% MBO stake acquired by Go-Ahead
June 1998	Virgin	49% stake in Virgin Rail acquired by Stagecoach
January 1999	M40 Trains	3i and part of MBO stake acquired by John Laing
February 2000	MTL Trust Holdings	Acquired by Arriva
July 2000	Prism Rail	Acquired by National Express

Source: TAS (2000)

The ownership of franchises as at 1996/97 has therefore changed to that as summarised in table 7, where the increased consolidation of ownership between bus and rail sectors can be clearly seen, as well as the changing status of some of the groups involved.

Table 7: British railway franchises, position at June 2001

Ownership type	Number	Franchisee	Number
Transport operator (with bus interests)	5	National Express	9
		Stagecoach	2
		FirstGroup	3
		Arriva	2
		Go-Ahead	1
Joint venture: bus operator and other conglomerate	2	Go-Ahead/Via-GTI	1
		Virgin/Stagecoach	2
Utility conglomerate	2	CGEA (Connex)	2
		John Laing	1
Transport operator (without bus interests)	1	Sea Containers	1
Rail operator	1	GB Railways	1

Updated from: Harris and Godward (1997: 100) with reference to table 6

Given that Connex, as well as their urban transport interests in continental Europe, had set up a company to bid to run tendered bus services in London in 2000, all but three of the franchises (the last three listed in table 7) were in the hands of companies with very strong bus industry links. Go-Ahead also briefly had rail interests in Sweden in 2000, but these were abandoned after a short period because of operating difficulties.

Structural changes are currently taking place within the British railway industry under the direction of the Strategic Rail Authority (SRA). With regard to the franchising structure, the SRA considers that the existing numbers of franchises, and of franchisees, are too many to permit a coherent, investment driven railway to develop. Hence, amongst the early actions of the SRA have been the extension of a number of short term franchises to their existing owner, the rebidding for some franchises on a longer term basis than previously (eg South West and South Central) and the selective redrawing of the franchise map in what is perceived to be a more logical way. The early evidence is that this is perpetuating the cross-ownership between bus and rail sectors. In decisions announced so far, Stagecoach have retained the franchise for South West Trains, whilst Go-Ahead are to take over the South Central from Connex during 2001.

5 INTEGRATED PASSENGER TRANSPORT

As referred to previously, cross-modal passenger transport integration has intermittently been an aim of certain governments since the Second World War, specifically through the 1947 and 1968 Transport Acts.

The concept of integration is one which is much discussed but rarely defined precisely. As an economic efficiency driven concept, it requires the elimination of unnecessary waste, by which there is an implication of the elimination of competition. This is best exemplified in Britain by the many interchange schemes which the Passenger Transport Executives, particularly, developed in the 1970s. Urban railway networks were perceived to be the optimal way of dealing with the movement of large numbers of people and bus networks were designed in such a way that they acted as feeder services into these. The 1985 Act, by giving freedom to bus operators to act in a wholly commercial way, virtually eliminated the raison d'être of the local transport interchange, the bus operator being free to provide the complete service rather than just a part of it, and many became redundant overnight (eg Waterloo in north Liverpool).

The UK Government's White Paper *A new deal for transport: better for everyone* (DETR 1998) frequently uses the term 'integrated transport', and has spawned the Commission for Integrated Transport, but, again, the term is not specifically defined. Its implication, however, is one of providing a framework of information, fares and infrastructure, that will allow the operator (of whichever mode) to function freely in a commercially competitive market and will allow the passenger to make informed choices about the services available to them. Specifically, it was an aim of the paper to "produce better public transport, with easier, more reliable connections" through "a modern integrated transport system" whilst addressing the issue of "inadequate regulation of monopoly supply".

The separate privatisations of the bus and rail industries in Great Britain were pursued with virtually no consideration for the other mode. Deregulation of the bus industry had a tendency to stimulate competing parallel services and the legalities connected with subsidy constrained the tendering authorities' ability to provide feeder services where these would conflict with the competitive market.

The original round of franchising which formed rail privatisation was slightly different, insofar as it allowed some qualitative enhancement features to be considered as part of the bidding process. These included the provision of selected bus links, and Charlton (2000: 44), citing Knowles (1998), makes reference to the 12 franchises awards which were secured on this basis. However, this was a minor consideration and the quantitative value of the bid was the primary criterion for selecting a franchisee. In addition to franchise commitments, there have been some commercially driven bus links, and White (2001) makes reference to those to the Virgin Trains/Stagecoach network, and by Go-Ahead at Oxford and Brighton, where these have resulted from cross-ownership between the two sectors.

A contrasting view on transport integration is provided by Hibbs (2000: 12) who regards the concept of integration implied by the White Paper as "… a call for more intervention, leading to the weakening of both effectiveness and efficiency". Other than with regard to safety and issues of scale and power, he regards public passenger transport as a market-based, customer-driven activity, particularly with regard to its relationship with the private car, from where most of its competition comes.

6 RESEARCH APPROACH

This research is based on a case study analysis of the ownership change process within the bus industry and the subsequent diversification by these companies into the rail sector. Similar approaches to research have been taken by Bryman, Gillingwater and McGuinness (1993) and Bradley (1998), although in these the studies were confined to the bus sector. These authors also focussed more on operational aspects of the bus industry, particularly competitive behaviour within the deregulated market, rather than at a more strategic level. As a result, their focus of attention typically was operating company based.

This study follows the same research process, namely the conducting of audiotaped interviews, their subsequent transcription and analysis, in order to understand strategy and, where relevant, identify similarities and differences in corporate approach. However, in contrast with the studies described above, the focus has been on the holding company. The interview programme began in August 2000 and is expected to continue until the end of 2001. When complete, about 40 interviews will have been undertaken, covering a broad cross-section of individuals directly involved in, or directly affected by, the ownership change process in the British transport industry in the period since 1985.

For the purposes of this paper, material from seven of these interviews has been used. For the purposes of confidentiality, these individuals remain anonymous, but all are current or former directors of companies with their origins in the privatised British bus sector which have then diversified in some way to rail. To allow cross-referencing between quotations, the seven interviewees have been designated [A] to [G] within this paper.

This original material has been supplemented, where appropriate, by material published elsewhere; in these cases, anonymity is not being compromised and full references are given.

7 EXAMINATION OF CORPORATE STRATEGY

All of the companies involved began as stand alone, management and/or employee owned companies and have gradually developed into much larger enterprises. The research has identified four key stages in the process.

A: Initial business growth

Table 1 summarises the privatisation of the 116 bus and coach companies which have been transferred from the public sector to the private sector as a result, directly or indirectly, of the 1985 Transport Act. As privatised, these were generally small or medium sized enterprises, with turnovers and purchase prices of less than £10m. Exceptions to this rule were the companies emanating from London Buses Limited and from Passenger Transport Authority sector, where the scale of enterprise was somewhat larger, with purchase prices being £20m and above, and reaching a maximum with the sale of West Midlands for £71m in 1991.

The emergent bus groups of the late 1980s, particularly those originating outside the management buyout process (particularly Stagecoach and Drawlane), illustrated the advantages of the larger business enterprise and thus encouraged several then independent free standing companies to develop in a similar way. To a degree personality driven, the groups expanded in parallel, eventually acquiring virtually the entire independent sector, as well as being extremely active in the privatisation process within the Scottish Bus Group, London Buses Limited and the municipal sector. (The Passenger Transport Authority owned companies were different, being sold to a variety of management/employee ownership structures as a predominantly political act by local politicians sceptical of the Government's privatisation policies.)

The independent company, and some of the smaller groups which had formed, faced a decision whether to become an acquisitive company or to seek a purchaser. Small scale acquisition enabled some degree of local security to be achieved:

> "Once we consolidated the situation [in our local area] we couldn't, other than organically, grow the patronage which there's no way you're going to do on a quantum leap but only on a gradual basis; [otherwise] then you had to look outside the area." [C]

Many companies were initially attracted by the competitive challenges of the deregulated market, but rapidly reached the conclusion that expansion through acquisition was a more cost effective strategy:

> "Our early intention was to try and grow by competition because that was what we initially felt deregulation was all about. Only after that experience, that relatively short experience, did we then change our view and said we need to be able to grow by acquisition. Equally what had happened subsequently was that there were a sizeable number or organisations that had become management/employee buy-outs, or whatever, and we then focused on those organisations with a view to seeing if we could grow our business by bringing them into our group." [B]

> "The open competition rule was just proven not to work. … There were certainly periods when we felt that competition on the road was seen as the most appropriate way of taking on the competition. If you were going to secure the network, securing your revenues and be able to reinvest in the future of the company then it was felt that too much competition on the road was going to be counter productive because if you were flooding the corridor with buses you weren't going to increase the number of passengers so all you were doing was taking the same amount of revenue and sharing it amongst a lot of people. In the end we looked at the alternative which was the acquisition route and quite frankly the commercial decision was taken that the cost of buying these companies was infinitely lower than the cost of trying to compete with them and put them out of business and it would take a long time to do it. So we went on the acquisition trail." [C]

The alternative strategy, one of being a selling company, is one which many management buyouts eventually faced:

> "We resolved as a Board [when we completed the management/employee buyout] to review the strategic future of the company about two years after we'd bought it. That came up with a series of options like refinancing, like more acquisitions, like trade sale – of which it became quite apparent, that by far the most sensible option was to attempt to sell it." [A]

In some cases, particularly the post NBC sales where the purchase prices were significantly higher, there was a reliance on outside venture capital to secure the buyout. In these companies, the venture capitalists' desire to realise their investment provided a further pressure to sell:

> "If somebody lends you [X] million at thirty per cent per annum and takes a seat on the Board, they take a pretty close interest in running the company. They never actually stopped us doing anything that we wanted to do; you needed their assent to do anything of any serious nature - which they gave us, when we justified it. … It had never been my delusion that we had necessarily much chance of long-term survival whilst we had venture capitalists involved." [A]

TAS (1999) provide an overview of the factors which have driven business consolidation as follows:

1. The latent instability of many of the companies, particularly those formerly owned by the SBG and PTEs, following their initial privatisation.
2. The ageing of many of the individuals involved in buyouts, the pressure of work during the intervening period and an opportunity to cash in on their investment.
3. The significant advantages of major groups over larger companies, particularly regarding purchase economies of scale, the use of modern technology to effect savings, and changes in employee terms and conditions.
4. The financial structure of fledgling management/employee buyouts, particularly their over reliance on loan capital, and the subsequent difficulties with funding new investment.
5. The desire of the established groups to be seen by the Stock Market to increase their turnover and profit which, in an industry where organic growth is virtually non-existent, must be achieved through acquisition.
6. The need for companies seeking Stock Market flotation to prove their worth to potential investors by expansion and to buy while other companies were still available.

However, with respect to point 3, although there are perceived benefits from consolidation, there is strong evidence that this is not always necessarily the case:

> "It is often said that ownership consolidation provides economies of scale to the groups. In one sense it does – we can probably buy our vehicles, tyres and fuel somewhat more cheaply that an independent operator – but I believe that economies of scale are overrated, because the benefits you gain from your purchasing advantage are very quickly spent in other ways. They are spent in terms and conditions of employment. The Groups probably have better pay packages – they certainly have generally better pension funds, better sick pay schemes, better other benefits – for the employees. So I do not attribute very much to economies of scale as a reason for ownership consolidation." (Moyes 2001)

Enlarging the company was felt to bring many benefits, particularly that of "having a seat at the table" [C], being regarded by the industry and the City as one of the influential forces in the industry.

B: Flotation and need to sustain business growth

The emergent groups were largely funded through debt, to a level at which it was unsustainable. Two alternatives again faced a company in such a business: sell out to another company in the sector or raise capital in an alternative way, namely through a stock market flotation. This allowed access to much larger amounts of non-debt capital, to stabilise the business and to provide for further acquisition, and it was also a way of responding to internal pressure for release of capital tied up in shares, particularly in companies whose shareholding was spread across large numbers of employees at different grades in the business.

> "Flotation … came about because of two things, really. One was that we had this pent up demand within the business that said that we needed to have a liquid share because there were a large number of people who, … (for example), … had retired from the business and had a sizeable value locked up within his shares but within the share market structure was not going to be able to unlock that for quite a period of time. … The other side was that you can only acquire so much by debt and the debt profiles within the business were starting to become quite high, and therefore to acquire still further you either had to restrict investment or you'd got to find another means of doing it. Flotation was therefore a sensible means of being able to solve both those problems." [B]

In the right circumstances, flotation was the most lucrative exit route for shareholders:

> "We had looked at one or two other situations, whereby we might do some mergers with other companies, in order to build up critical mass, but none of them came to anything. … [Another company] … wanted

> to grow their share in [the local area] – so one way would be to buy us. We worked out how much they were willing to pay for the company – I think it worked out about [X] million or something like that – which was more than most other people had indicated, whereas, if we floated, the company would be worth [almost twice that]. So we felt, on behalf of the shareholders, there was just no way that we could turn down flotation." [D]

Ultimately six companies took the full stock market flotation route: Stagecoach, Badgerline, GRT, National Express, Go-Ahead and, much later in the process, Metroline. Badgerline and GRT later merged as FirstBus, later renamed FirstGroup. Arriva, already quoted as Cowie plc but with very limited interests in the bus and coach industry, became a major listed bus owning group when it purchased the assets of British Bus. In addition, Southern Vectis is listed on the junior Alternative Investment Market.

Once quoted, these businesses were driven to a much larger degree to provide a stable growth profile and to maintain an increasing share price.

> "What is significant is that investors in quoted companies – five of the major groups have stock market quotations – demand growth, year on year. When you are a quoted company, you no longer have the option to have a bad year, even if you think that it is probably all right because you know that the year after will be better. In a mature market, which the public transport market – certainly the bus market – was, the scope for organic growth is quite limited, even in the best areas in the country. Therefore, if you are going to satisfy the stock market and keep moving on the treadmill, you have to look for acquisitions, to demonstrate growth, to maintain your rating in the City and to maintain your ability to raise funds." (Moyes 2001)

> "The requirements of improved profitability do mean that you've got to look at the business in a different light. You've got to be in a position where you're satisfying the performance levels that you have said that you are going to achieve, and this does therefore bring much more of a focus on a profitability number or a forecast profit number every year, or every six months. You can't afford to miss that because you are essentially risking your share price if you don't. So you've got to be much more focused on the profit line." [B]

> "A problem undoubtedly is that City expectations were raised very high in terms of bus returns. My own view is that a 10% return is very acceptable as buses, by and large, are good "cash cows" – pretty stable businesses as long as you do your job properly. Yet that's no longer good enough in the City – it's got to be 15% this year, 16% next and 17% the next." [F]

Management emphasis changed from one of running a transport company to one of running a business answerable to the stock market:

> "[The Board's role changed] significantly I would say, mainly because of the year-on-year drive to be able to achieve growth in profits. The first few years were reasonably easy to do that because you had a situation where you were able to acquire new businesses, you were able to grow the profitability in those businesses and that you were able to show the stock market that there were other businesses out there that you could acquire as well and therefore they were quite comfortable that." [B]

Beyond that, the problems were threefold – a significantly reduced supply of further businesses to acquire, limited scope to reduce costs further and a core market which, irrespective of regulatory regime, has been in steady decline for about 50 years, as shown in table 8. A further factor in terms of acquisition was the threat of regulatory authority intervention once the size of groups approached 25% of the British market.

> "When you get to the [almost 25] per cent market share that ultimately we got to, and that in a declining business, it's much more difficult to try and show profit growth trends. You can initially satisfy that by actually increasing the efficiency and the effectiveness of the business but you get to a situation where you've got to be able to grow the revenue line and in an industry which was much more cost-driven, that was much more difficult to do." [B]

Table 8 has been interpreted by some as direct evidence of the success of the 1985 Transport Act, insofar as the rate of decline in passenger numbers has been reduced (although it masks the fact that growth in some geographical areas is set against significant losses in others). An alternative interpretation may be that the British bus industry has now lost the majority of passengers which it is likely to lose, primarily to the private car, and that the remaining, almost captive, market is made up of those who, for reasons of age, incapacity or, in some cases, choice, remain non car owners.

Table 8: Bus passenger journeys lost under different organisational structures

Period			Passenger miles lost (millions)	Average loss per year (millions)	Average annual rate of decline (%)
1	1950-1970	'Regulated monopoly' under the Road Traffic Act 1930	7758	387.9	-3.5
2	1970-1974	Following the introduction of the provisions of the Transport Act 1968 and the formation of the Scottish Bus Group and the Passenger Transport Executives. Two thirds of the industry is now in public ownership.	971	242.8	-3.0
3	1974-1985/86	Following the introduction of the Local Government Act 1972, with the identification of the new Metropolitan County Councils as Passenger Transport Authorities, and the development of network subsidy.	2075	188.6	-3.2
4	1985/86-1990/91	The period immediately following deregulation and privatisation.	1304	116.9	-2.2
5	1991/92-1997/98	The decline slows as privatisation and other benefits work their way through after the immediate upheaval which in some areas followed deregulation. Over the last four years the slow down in the rate of decline has been even more marked, and the movement either way has been less than 1%. In certain areas there has been a distinguishable upturn in bus carryings, a significant part of it representing a shift from travel by car.	328	54.6	-1.2

Source: Hibbs (2000: 39) citing TAS (1999: B2)

C: Entry into the railway sector

The combined factors of a stock market listing and the need to demonstrate sustained growth, set against presence in a market with declining patronage and a lack of ongoing merger opportunity, meant that bus groups have therefore needed to look beyond their core market for expansion.

> "We got to a situation where we were essentially [almost 25] per cent of the bus industry. It was therefore going to be increasingly more difficult for us to grow further that market share and we therefore recognised that we'd got to find some other means of growing and that therefore meant that we needed to change from being a bus operator to a public transport operator." [B]

The majority of bus groups followed broadly similar paths, seeking out and achieving merger and takeover in other transport sectors. In the bus industry, overseas acquisitions were pursued. In other transport modes, privatisation opportunities were taken in the airport sector, but the Railways Bill presented an accessible opportunity for diversification. Through a lobbying group, a certain amount of influence was brought to bear on the way the legislation was framed.

> "A number of [bus] operators got together … in an informal way – called PROF, the Prospective Rail Operators Forum. … We actually got quite close to the civil servants that were doing the drafting and then, subsequent to that quite close to the OPRAF people as they were beginning to be recruited. I think that group – and there were about 14 of us all together – had some influence in the way the Railways Act subsequently came out; a little influence – I wouldn't say it was a major influence – but we had some input and were listened to." [E]

As well as the need to exhibit growth, it was perceived that the circumstances of rail privatisation had a degree of commonality with the groups' prior experience. One manager described the attraction of rail privatisation to the bus groups:

> "I think, as much as anything, … [the bus groups had] … been through a privatisation process and realised that there were some opportunities there – and it was transport; I think – those were the two key issues. I think we were all alive to the fact that there could well be opportunities as good as there'd been in the bus industry privatisation. Everyone else was rubbishing the privatisation, but we'd been there,

> we'd seen it and we realised that it was actually going to happen and it was going to happen in a way that could be of advantage to us. It would be nice to use the work 'farsighted' but that's probably being very pompous about it, but I think we realised that there were possibilities and we felt that we could bring the disciplines that we'd learnt in the bus industry to bear on the railway industry – which subsequently did prove to be the case." [E]

The bus industry's interest in rail privatisation is evidenced by the data in table 4; approximately two thirds of bids submitted for the available franchises were either directly, or linked indirectly, to bus groups. 20 out of the 25 rail franchises were awarded to bus groups, as discussed earlier. In strict business terms, it provided a more balanced portfolio of interests than a company limited to the bus sector. Contrary to some expectations, the rail market has expanded in the period since privatisation, although this almost certainly has more to do with external economic circumstances than it does with the privatisation process itself.

> "Unlike buses, … commuter operations into London are impacted by central London employment and the InterCity services are impacted by GDP. There is an element of that that therefore says that they will, if the economy is strong, they will still continue to grow. Well I think that the reality is that you've been able to have a growth of passengers on one side because of the economy, and an improved provision, I think, with regard to growing the number of services that are available. And on the other side you've been able to improve the profitability to get the investment into the thing by reducing the cost of operation." [B]

Provided that the declining Government subsidy profile has been correctly provided for, this organic growth is able to deliver the progress expected by the stock market without demanding further merger or diversification.

D: Management and operational synergies between the sectors

Certain synergies exist between the two sectors, particularly in the immediate aftermath of privatisation, as described by this manager:

> "There are natural synergies and there are natural parallels in that [they both come] from previously state owned, strongly unionised [backgrounds]. The drivers are the "all power" but they are the ones who are generating the revenue, they are the ones who are out driving the buses, driving the trains which are actually giving the customers the service they require." [C]

Operationally, there are also synergies, but clear differences with regard to the network:

> "There are obvious parallels in terms of running networks, timetabling, passenger requirements. There are bigger risks around rail because of the Railtrack involvement; there are more parties to the equation. It's a bit different negotiating with Railtrack than it is with the Highways Agency and, at the end of the day, you can always find a different route for your bus but you can't find a different route for your train." [C]

> "The bus business you can control; the rail business, at best, you can influence because of all the contractual parties, the various regulatory authorities, the political involvement etc." [F]

In contrast to a non bus operator taking on a franchise:

> "I suppose only that we'd already been there and that we understood the movement of people perhaps. I think the big thing was everybody was scared of railway privatisation – the bus companies weren't, although some of the bus companies were. … [Some bid early but others] didn't want to get involved and just were forced into it at the end, or were they just waiting and seeing and see how other people went before their bid went in." [E]

A difference in management culture faced the diversifying bus group. One manager described this difference at the time of privatisation thus:

> "[It was] quite dramatically different. I think the railways felt that no one else could do anything as well as they do, everything that they did was perfect, and of course that wasn't the case. I think the attitude was beginning to change with some of the young people that were coming through in British Rail … [but] … some of the other old stagers were quite entrenched in their views." [E]

Groups took different approaches to transferability of management skill following privatisation. Some groups pursued a policy of keeping the two areas of the business separate from a managerial point of view:

> "In the main the directors were obviously involved in both aspects of the business but on a day to day management basis the rail men ran the rail company and the bus men ran the bus company" [C]

although this practice was not universal and there are several cases of former bus managers being appointed to senior and middle managerial positions in the rail industry in the post privatisation period. Such experience was able to bring new skills to the sector, and also allow certain skills to be transferred back to the bus sector:

> "I think it was the commercial experience of running buses, in terms of being in the commercial world – the proper commercial world – for ten years or so that was the helpful part. … [W]e continued to use their expertise as individuals in how to run the thing. I suppose the cultural one was that it had been a protected environment for a number of years and we had to get that commercial edge to it so that they understood what … the requirements were for profitability. … [T]hey were the opposite to us again in that they were good on developing their revenue lines, good at understanding their passenger requirements, good at knowing the passenger profiles, not strong on their costs, and certainly I think that the bus industry learnt quite a bit from them as to how to understand its market place really, and I think that the foray into rail has been beneficial." [B]

> "I think what the bus industry brought to rail was an ability to make decisions because we'd been in the deregulated and privatised era ten years, standing on our own two feet, whereas the rail industry had been in the nationalised, committee style "not my decision, it's our decision, we'll throw it over to the next committee, make a decision next year" culture. … We gave a dynamism to the rail industry which would have come because of the sheer pressures on it but we helped in getting it started." [F]

Part of the reverse flow of expertise was related to marketing and customer service:

> "[The rail industry's] marketing techniques and their analysis of their own individual passengers, [and] their revenue profiles on their business, were quite sophisticated and we were therefore able to transfer some of the way in which they used this revenue development techniques onto some of the bus operations that we had. It doesn't transfer across in its entirety, but nevertheless if you're looking at new opportunities for example then you can use some of the marketing techniques that they had to give you a view as to whether it's a sensible thing to do or not, whereas the past view on buses might have been 'well, let's stick a bus on and see what happens'. [B]

As noted previously by several interviewees, the bus industry had been active in reducing costs and rapidly noted this as a possible way to assist with improvements to the commercial position in rail sector:

> "We saw the railway as being absolutely stuffed with staff, all earning a lot of money and perhaps not doing very much, and we saw massive cuts in staff levels as a possibility, which actually happened. But you then built staff levels up in other areas – in commercial areas and things like that. … I think we saw all the excesses that there had been in National Bus Company in terms of inefficiencies, overstaffing and costs - multiplied n times in the railway, and of course … [we] … had had contact with railways over the years through standing joint committees and things like that. … We saw that there were a lot of [potential] cost savings. We also saw that their operational efficiency could be improved in terms of scheduling etc, because I think there was a lot of slack scheduling and poor utilisation of operational staff, and I think thirdly we saw that the commercialism of the railway left an awful lot to be desired and bus companies had begun to develop that commercialism. I don't think we saw ourselves as magic wand wavers, we just saw that, here again, there was another opportunity to do the same as people had done in the bus industry." [E]

Although some franchise agreements had stipulated transport integration through bus links, some managers are of the view that it was very peripheral to the activity of operating the rail business in isolation. One manager commented:

> "I think that it [bus-rail integration] was a tag on to the exercise. … With regard to satisfying the integrated transport requirements, a number of additional feeder services have been provided by the bus operators. I think the real integration has been on people really because you've had more of a mix between the two so that you've therefore got bus operators that now work within rail and vice versa, and I think that that's good." [B]

Others viewed it as unnecessary, one manager citing his own research from the 1970s:

> "One thing of course that is being preached at the moment, and is always preached, is integration which I feel is very dangerous. The average bus passenger has no interest in rail or vice versa and I remember when we did a survey in Peterborough only 2% of our passengers came from trains. Know that's a great many years ago but I doubt that it's changed." [G]

In certain cases, the figure is clearly higher than the 2% cited, and a true market exists for modal transfer. Indeed even 2% may have a significant impact on bus company margins and should not be disregarded. One manager notes that the level of integration provided by his company significantly exceeded that required by the franchise bid. Where it has occurred, integration has generally been well received:

> "On the whole, … [consolidation between the bus and rail sectors] … seems to me a beneficial development. It permits a transfer of expertise in management between the bus and rail sectors. It also eases the development of integrated bus-rail services so we have Stagecoach companies feeding Virgin Rail, with which they are associated; Go-Ahead Group bus companies feeding into Thames Trains at Oxford and Thameslink at Brighton; and ticketing integration between Travel West Midlands and Midland Metro, both under National Express." (White 2001)

However, the same commentator is of the view that cross-modal ownership is not necessarily essential for such developments. The implication is that clear provision of information through marketing and through ticketing are more important aspects of the process than the ownership regime.

Integration is seen by some as very much a local initiative and of less strategic or transport policy related importance:

> "There is a great deal of integration going on, but it is a reasonable criticism of the industry – certainly the bus industry that we do not say enough about what we actually do. A great many incentives are going on, but we are essentially a local business, and people who are local are unlikely to know what these options are, and probably do not spend so much time talking about them nationally." (Depledge 2001)

8 CONCLUSIONS

Cross-modal ownership between the bus and rail sectors has developed to a large degree, to the extent that all but three of the current rail franchises are in the hands of companies with significant interests in the bus industry. In the majority of cases, these have followed a common business cycle:

1. Acquire bus company from public sector through privatisation.
2. Expand through acquisition and seek additional funding through a stock market flotation.
3. Faced with the conflict of a declining bus market, an exhausted pool of merger targets and stock market pressure for growth, diversify into the rail sector.
4. Examine the potential for synergy between the two sectors and implement where appropriate.

Generally, although not exclusively, cross-modal ownership has been driven by Stock Market pressure for business growth more than any other factor. Some groups have been able actively to transfer management expertise between the two sectors; this has been particularly true in the cases of commercial and cost awareness (bus to rail) and marketing techniques and market segmentation (rail to bus).

Transport integration, in the form of feeder links and/or ticketing and marketing initiatives, has occurred to some degree, but it not generally viewed as significant by the majority of managers whose views were canvassed. Where the practice does generate benefits, it does not necessarily require the existence of cross-modal ownership.

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APPENDIX: OWNERSHIP GROUPS WITHIN THE BRITISH BUS INDUSTRY (AS AT 1985) AND SUBSEQUENT CHANGES

1 National Bus Company (NBC)

The NBC was state owned, and operated via territorial subsidiary companies in England and Wales. The disposal process of the subsidiaries is described fully by Birks et al (1990: 663-700). Companies were advertised for sale and interest was attracted from outside bidders as well as, in almost all cases, teams of managers and/or employees. Some advantages presented themselves to buyout teams over third party bidders. Being in situ, they were able in many cases to lodge bids earlier than third parties and be more confident in their valuation of the company. Set against this were the problems of raising large amounts of purchase capital, problems which applied less to a third party with a track record of borrowing. Management/employee teams also had the advantage that they could be declared the preferred bidder even if their bid was not the highest - the so called “employee discount”. The Disposal Programme (NBC 1986) stated, however, that the inside bid would need generally to be within 5% of that offered by a third party. The sale of NBC subsidiaries took place between August 1986 and April 1988.

2 Scottish Bus Group (SBG)

The SBG was the Scottish equivalent of the NBC, again operating via territorial subsidiaries. The 1985 Transport Act had made no direction to dispose of the SBG but, with NBC privatisation beginning to produce greater disposal proceeds than had been foreseen by some, the decision was made to sell off the SBG in a similar way. In early 1988, the Secretary of State for Scotland announced the intention to sell off the Scottish Bus Group. The SBG was again disposed of by the separate sale of stand-alone subsidiaries, with sales taking place between August 1990 and October 1991.

3 Local authority owned companies

At the peak, over 100 local authorities owned and operated their own local bus networks. This number was significantly reduced in the late 1960s and early 1970s by the creation of seven Passenger Transport Executives (PTEs) – see below.

The 1985 Transport Act proposed that those local authorities still operating buses should be placed on what was perceived to be a level playing field with all other existing or envisaged companies. Local authorities which still owned and operated their own bus companies, with the exception of those with very small fleets, were required to establish them as ‘arms length’ subsidiary companies no later than ‘Deregulation Day’ (26 October 1986). 46 companies were created in this way. No specific legislation existed to force their disposal but the Government made it clear that it would encourage councils to sell off their businesses.

The sell off took place on a piecemeal basis from June 1988 onwards, although with added impetus given by an ultimatum from John McGregor, the then Secretary of State for Transport in 1993, who directed that sales must be completed by 31 December 1993 if the owning authority wished to keep the entire proceeds of the sale. After that date, 50% of the proceeds would have to be used for the reduction of debt, effectively passing to the Exchequer, although in the event some sales took place after the designated strike date without any penalty. Several of the sales took place on a ‘distress’ basis, one (Darlington) being liquidated before a sale could be completed.

The most recent sale took place in 1996. As at June 2001, 17 still remain in local authority ownership, although two of these have minority shareholdings owned by overseas-based transport groups.

4 Passenger Transport Authority (PTA) owned companies

The seven PTAs had their origins in the 1968 Transport Act, the first four being created in 1969, the other three following by the mid 1970s. The English PTAs were, by the mid 1980s, answerable to the Metropolitan County Councils in each area though, with the abolition of these Councils, they had become answerable jointly to the Metropolitan District Councils in the area. Until 1986, they had each owned and operated their own bus fleets via a Passenger Transport Executive (PTE). Under the 1985 Transport Act, they had been required to create an ‘arms length’ company, owned by the PTA and free of interference by the PTA.

As with those companies directly owned by local authorities, there was no specific legislation to enforce the sale of the PTA companies but similar strong pressure was applied by the Government on those authorities which did not pursue divestment of their own volition. Although it had been suggested that the companies were mostly too large to sell off whilst retaining sufficient competition in the local market, the instruction to split was only applied to Greater Manchester Buses Limited, which was split into North and South companies in 1993.

Six of the seven companies were sold as single entities. The seventh, Greater Manchester Buses, was split into two under Ministerial direction prior to sale. Disposal of the eight PTA owned companies was quite spread out, taking place between October 1988 and March 1994, all being sold to teams of managers and employees.

5 London Buses Limited

London Buses Limited (LBL) was the ‘arms length’ bus operation under London Regional Transport. It had been set up following the 1984 London Regional Transport Act as part of the Conservative Government’s policy of removing power from a confrontational Greater London Council, as explained by Garbutt (1985). LBL had developed to function via a series of increasingly autonomous bus districts. Initially there had been eight of these but this figure was reduced to six in 1984 and to five in 1987. As a response to the route tendering process which the 1984 Act introduced, a series of smaller semi-autonomous low cost units had been created in 1985/86.

Eleven bus operating subsidiary companies were created out of the five bus districts although one of these, London Forest Travel Limited, was disbanded before privatisation. Two further subsidiaries were Stanwell Buses Limited (trading as Westlink), which was one of the low cost units described above, and London Coaches Limited, which operated tourist services in central London and commuter coaches from Kent.

Sales were on an open tender basis and, although the Department of Transport was keen to encourage bids from management/employee groups, outside bidders were not to be put at a disadvantage. The target was clearly one of maximising sale proceeds, although it was made clear that no single purchaser would be permitted to buy more than two of the eleven companies still for sale, London Coaches having been sold to its management in May 1992. The eleven businesses were sold between January 1994 and January 1995.

6 Independent companies

Although there were many hundreds of independent businesses in 1985, relatively few were involved with scheduled bus or coach operations on anything other than a very small scale. There has been much fluidity in this sector with long established companies ceasing to trade or being bought out by the emergent bus groups. Equally, many new business have been established, some developing into medium sized enterprises in their own right, others ceasing to trade or selling out after relatively short periods.